

**DEPARTMENT OF STATE REVENUE**  
**LETTER OF FINDINGS: 07-0125**  
**Gross Retail Tax**  
**For the Years 2003, 2004, and 2005**

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**ISSUE**

**I. Equipment Used in the Direct Production of Tangible Personal Property – Gross Retail Tax.**

**Authority:** IC § 6-2.5-5-3(b); IC § 6-8.1-5-1(b); 45 IAC 2.2-5-8; 45 IAC 2.2-5-8(a); 45 IAC 2.2-5-8(c); 45 IAC 2.2-5-8(d); 45 IAC 2.2-5-8(g).

Taxpayer argues that two categories of equipment – steels uncoilers and material feeders – are exempt from sales tax.

**STATEMENT OF FACTS**

Taxpayer is an Indiana manufacturer of auto parts. Taxpayer uses automated presses to stamp out small aluminum or steel auto parts. The Department of Revenue conducted an audit review of taxpayer's records concluding that taxpayer owed additional gross retail (use) tax on items purchased during the three years under audit consideration. Taxpayer disagreed with a portion of the audit's conclusions and submitted a protest to that effect. An administrative hearing was conducted during which taxpayer's representative explained the basis for the protest. This Letter of Findings results.

**I. Equipment Used in the Direct Production of Tangible Personal Property – Gross Retail Tax.**

**DISCUSSION**

The audit concluded that taxpayer's purchases of uncoilers and material feeders were subject to use tax. The audit report indicates that taxpayer was asked to differentiate the costs of the matched uncoilers and material feeders but taxpayer declined to provide the requested information.

It is taxpayer's responsibility to explain the basis for its protest and to justify the relief requested. "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." IC § 6-8.1-5-1(b).

45 IAC 2.2-5-8 allows the taxpayer to purchase machinery, tools, and equipment without payment of the gross retail tax when the equipment is used in the direct production of tangible personal property. 45 IAC 2.2-5-8(a) specifies that the exemption is limited to that equipment “used by the purchaser in direct production.” 45 IAC 2.2-5-8(c) specifies that “directly used” means that the equipment has “an immediate effect on the article being produced.” Refining the definition one step further, the regulation states that “[p]roperty has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.” *Id.* See IC § 6-2.5-5-3(b).

The audit report found that taxpayer’s uncoilers were subject to gross retail tax because the uncoilers did “not materially change the raw material but only holds the rolled coil as the production machinery calls for more material.” The audit report also found that taxpayer’s material feeders were subject to gross retail tax because the material feeders “do not significantly change the material prior to press operation and no new unique good is created.”

#### **A. Uncoilers.**

The taxpayer's facts are similar to those the Department dealt with in a different Letter of Finding (See 04-0268). The Department found (in pertinent part) in that Letter of Findings:

[T]he uncoiler straightened the steel. While this was necessary to begin the process by which Taxpayer produced tangible personal property, the straightening of steel preceded the process in which the steel eventually became steel tubes. As such, the uncoiler did not have an immediate direct effect on the property in production, and thus did not constitute part of the production of other tangible personal property.

The Department reiterates the reasoning of Letter of Findings 04-0268 and applies it to the case at hand. The uncoilers do not meet the requirements of IC 6-2.5-5-3(b) that the equipment be used for "direct use in the direct production . . . of other tangible personal property." The uncoilers fall within the category of equipment defined as “pre-production” as outlined in 45 IAC 2.2-5-8(d). The uncoilers are separate, distinct, items of equipment which do not have an immediate effect on the tangible personal property. “The fact particular property may be considered essential to the conduct of the business of manufacturing because its use is required . . . by practical necessity does not mean that the property ‘has an immediate effect upon the article being produced.’” 45 IAC 2.2-5-8(g).

#### **B. Material Feeders.**

After the raw metal is dispensed from the uncoilers, the metal is fed into material feeders (alternatively referred to by taxpayer as “straightener feeder”). The audit concluded that the material feeders were subject to gross retail tax because the material feeders did not significantly change the metal. Taxpayer argues that the material feeders do have an immediate and direct effect on the metal because the material feeders act upon the metal to remove the “coil set.” “Coil set” is an innate curvature of the metal somewhere between perfectly flat and the degree of curvature as defined by the outside coil circumference. Taxpayer states the material feeders

“use[] a series of rollers that alternatively stretch and compress the upper and lower surface of the coiled steel so that the material’s yield point is exceeded.” Taxpayer explains that “different tensile strengths and thicknesses of metal require differing amount of pressure to remove the coil set.” The materials feeders accommodate the differing metals the “pressure on the rollers is adjusted for specific thicknesses and tensile strengths of the material being straightened.”

Taxpayer has included copies of the material feeders’ instruction manual which verifies taxpayer’s description. Taxpayer’s material feeders fall within the exemption provided under 45 IAC 2.2-5-8 because the material feeders act in such a way as to have an effect on the tangible personal property being produced by the taxpayer and because the material feeders are within taxpayer’s production process. The material feeders are more than simple transport devices used to facilitate the transfer of the raw metal from the coil reel to the first production machine. Instead, the material feeders act upon the metal to change the metal’s inherent structure in the same manner that a punch press, a lathe, or cutting torch act upon raw metals. After the metal has gone through the material feeders, the metal that is dispensed is different from the metal originally on the coil feeders having been physically transformed in an initial step of taxpayer’s production process.

Taxpayer has not met its burden of demonstrating that the uncoilers are directly used in the direct production of the auto parts. Taxpayer has met its burden of demonstrating that the material feeders are used in the direct production of the auto parts. However, it remains taxpayer’s responsibility to differentiate the costs of the uncoilers and the material feeders.

### **FINDING**

Taxpayer’s protest is denied in part and sustained in part.